From Producer to the World

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Alliance Grain Traders
Third Quarter 2013 Financial Results
Conference Call Transcript

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Speakers:

Murad Al-Katib
President and CEO

Lori Ireland
Chief Financial Officer

Omer Al-Katib
Director, Corporate Affairs and Investor Relations

OPERATOR:

At this time I would like to turn the conference over to Omer Al-Katib, Director, Corporate Affairs and Investor Relations. Please go ahead, sir.

OMER AL-KATIB:

Thank you, Operator. Good morning everyone and thank you for joining us on our 2013 conference call. On the line with us today we have Murad Al-Katib, President and CEO of Alliance Grain Traders, and Lori Ireland, our Chief Financial Officer.

Before we get started, I would like to remind everyone that today's call may include forward-looking statements. Such forward-looking statements are given as of the date of this call and involve certain risks and uncertainties. A number of factors and assumptions were applied in the formulation of such statements and actual results could differ materially. This call may also include references to certain non-IFRS financial measures. For additional information, with respect to forward-looking statements, factors and assumptions, as well as reconciliation to IFRS measures, we direct you to our news release, our website, as well as our recent filings on SEDAR.

With that, I would like to turn things over to Murad for some comments, and then we'll go to questions.

MURAD AL-KATIB:

Thank you, Omer, and thank you everyone for joining our conference call this morning. The current year has been a positive one to date; we're optimistic this will continue with positive tones, both for our sector in general and our Company in particular. We have spent a lot of time over the past year or so speaking about the necessary conditions for the continued normalization of global pulses and staple food markets. The sector has been hit hard since 2010, with various supply disruptions, macroeconomic headwinds and other factors that had negatively impacted the sector and with them our business and our earnings. Conditions, we expected, would normalize in 2013. And as we forecasted, signals towards normalization continue to be present in pulses and staple food markets, leading to continued improvement in our earnings.

With the Canadian harvest completed, timing on it has been slightly late, which has impacted us somewhat with regard to shipments in the third quarter period. However, these types of timing-related shifts from one quarter to the other are expected, and really commonplace. However, quantity is significant, and the quality of the crops produced has been good. Product has been flowing into our North American plants. We've been very busy processing and shipping in a period that leads into a traditional busy period for global pulses and staple food markets.

At this time I'm going to call on Lori Ireland, our CFO, to discuss results from our third quarter. Lori?

LORI IRELAND:

Thanks, Murad. We're pleased to report that the quarter ended September 30, 2013 once again showed an improvement in gross profit, adjusted gross profit and EBITDA per tonne when comparing to both the quarter, the same quarter last year, and the prior quarter. Although there was an overall reduction in invoice tonnes, EBITDA improved to 14.4 million for the quarter ended September 30th, 2013, compared to 13.9 million for the quarter ended June 30, 2013. EBITDA also improved when compared to 11.5 million for the quarter ended September 30th, 2012.

The pulses and grain processing segment results for the quarter ended September 30th, 2013 showed a decrease in invoice tonnes; however, it showed an increase in gross profit, adjusted gross profit and EBITDA per tonne when comparing to the quarter ended June 30, 2013. This is a result of product mix decisions that resulted in higher margins per tonne being recognized.

The supply chain management and distribution segment showed a lower gross profit, adjusted gross profit and EBITDA per tonne and increased tonnes invoiced in the quarter ended

September 30, 2013 compared to the quarter ended June 30th, 2013. This segment includes traded tonnes at lower margins, which is offset by higher margin invoice tonnes through the operations of Poortmans and Advance Seed. The decrease in the quarter is due largely to low margin sales executed out of Australia in order to make use of empty rail cars. The consolidated margin data is inclusive of all tonnes transacted on an intercompany basis. There was an excess of 50,000 tonnes shipped between AGT subsidiaries during the quarter.

Year over year results for the quarter ended September 30, 2013 showed a 13% improvement in EBITDA per tonne when compared to the quarter ended June 30, 2013. We saw an overall reduction in the combined general and administrative and marketing sales and distribution expense in the amount of $1.1 million when comparing the quarter ended September 30th, 2013 to the previous quarter.

Finance expense decreased for the quarter ended September 30, 2013 compared to the quarter ended June 30th, 2013 due to lower utilization of credit facilities throughout the quarter. Non-cash foreign exchange includes a snapshot of outstanding foreign denominated accounts receivable and payable as well as outstanding foreign exchange contracts and includes the contracts related to the high yield bond. Note that this is a non-cash item and will fluctuate depending on the strength or weakness of foreign currencies when compared to the Canadian dollar.

Adjusted earnings per share were 24 cents basic and diluted. This is an improvement over adjusted earnings per share of basic and diluted for the quarter ended September 30, 2012. I want to remind our investors and analysts that AGT tracks adjusted earns per share, as it is reported exclusive of non-cash foreign exchange of our global business. Early on in our reporting as a public company, we decided to ensure that these effects were clearly stripped out of are our results. Inclusion of both gains and losses that result from snapshot non-cash IFRS effects do not accurately reflect the cash flow-generating ability of our business.

Net debt increased from $296.1 million at June 30, 2013 to $319.6 million September 30, 2013 and compared to $267.2 million at December 31, 2012. The increase in net debt of $23.5 million when comparing to June 30th, 2013 is the result of increased bank indebtedness and lower cash levels due to significant cash requirements such as the posting of bid, performance, and import tax bonds related to government, United Nations, and non-governmental aid agency tenders and contracts. An increase in property, plant and equipment related mainly to the completion of the Minot facility also affected the net debt total as of September 30, 2013. The late North American harvest also added to the net debt number, since product procurement activity sped up later on in the quarter and resulted in lower cash balances. Metrics continue to be calculated for each facility and performance targets are being tied to inventory and accounts receivable turns at each plant and country operations level.

Both accounts receivable days outstanding and inventory days outstanding improved when comparing the 9 months ended September 30th, 2013 to the year ended December 31, 2012 and to the same period last year. Accounts receivable days outstanding decreased from an average of 70 days for the year ended December 31, 2012 and from 73 days for the 9 months ended September 30th, 2012, down to 56 days for the 9 months ended September 30, 2013. Inventory days outstanding decreased from an average of 86 days for the year ended December 31, 2012 and 79 days for the 9 months ended September 30th, 2012, down to 77 days for the 9 months ended September 30th, 2013.

AGT continues to focus on these metrics, as well as on initiatives to lower cost and increase efficiencies. Thank you.

MURAD AL-KATIB:
Basically, we see a rise in gross margins per tonne and other metrics continuing to improve, and as Lori mentioned, our days inventory and accounts receivable outstanding. As a result of the balance sheet and working capital management initiatives we've implemented, aimed at increasing the inventory and receivable turns, we’ve been successful in therefore reducing overall cash cycles, and Management continues to be focused on reducing working capital debt as a percentage of revenues and equity capital.

As we indicated earlier with the scale and size of operations, margin improvements on existing tonnes handled through our facilities can have a material impact on improving our earnings going forward. We expect the potential for a robust traditional shipment period ahead in the coming quarters. In fact, we did feel that the Canadian harvest being one of the largest on record will certainly allow local market stocks that are continuing to need replenishment to be addressed without supply questions in many key markets. The upcoming shipment periods may be some of the busiest we've seen in our Company, which we expect may have positive impact on our earnings and margins.

India and the Indian subcontinent have continued to buy from Canada in the period leading up to the new North American harvest where they're traditionally not in the market. Shipments to Turkey and the Middle East-North Africa region have also been strong as well. Conditions have certainly assisted in bringing supply and demand fundamentals back into balance, which is not been the case for some time, with this balance assisting in the stabilization of prices and the increase in our margins. This is good news for the traditional shipment period later this year and early in 2014.

However, the improvement in our core legacy business is not the thing that's giving us the most optimism. With regards to the next phases of growth and development in our Company, we continue to be excited about our new food ingredient platform for pulses, flours, protein, starches and fibres, that we feel positions us for growth and transition from a commodity exporter to a food company.

This new business line centres around our Minot, North Dakota facility for production and distribution of these ingredient products and our new R&D research centre in Saskatoon, Saskatchewan, focusing on collaborative research and application development with global food companies, and innovation on the uses of pulse ingredients. The Minot facility has completed construction; it's nearly completed on commissioning, with commercial shipments moving out of the plant to satisfy both our marketing agreement with Cargill on pulse protein for branded feed in North America, but also for other global customers looking for a quality supplier of non-GMO, high protein, high fibre ingredients, or new and innovative sources of starch ingredients and flour blends for use in their products, whether for human consumption or for feed, pet food or aquaculture. We're working hard, both with our marketing partner Cargill and through our own sales and marketing channels, to make this new business line a significant growth opportunity for AGT to achieve scale in the coming periods.

As we develop sales opportunities in this area and complete the ramp-up of the first phase of production, we will make decisions on further planned expansions, such as adding two additional production lines to Minot, or we'll continue to examine the feasibility and cost of conversions of existing available capacity in Canada, in Turkey, and also in the United States. This will assist AGT in ramping up the food ingredient platform in 2014 and 2015. The potential growth trajectory of our ingredient business, we expect, may allow it to be material contributor to earnings in 2014 and ’15, and we are very excited about the feedback we're getting from global food companies and customers.

Our food ingredient business provides the basis for a new segmented reporting in pulse ingredient and packaged foods that we plan to unveil in the fourth quarter of 2013. This new segment may provide meaningful disclosure to our shareholders and the capital markets globally of a platform that we feel has great potential in our transition to potentially higher margin retail and food ingredient business.

For some time we've operated successful retail brands in business distribution in Turkey, in Europe and in Southern Africa. For example, our Arbella pasta brand, we estimate, may be one of the most widely distributed brands of pasta in the global market, being sold in 83 countries and with a number three position in the Turkish domestic market, according to available market data. Our Pouyoukas foods brand is widely distributed through Southern Africa, and our Arbel brand of rices, pulses and bulgur is distributed throughout Turkey, Central Asia, the Middle East and Europe.

Opportunities to increase the distribution of our milled wheat, rice, popcorn and other retail products to consumers globally in both the retail and food service sector is an opportunity for this Company. We'll continue to examine those opportunities, along with further opportunities for private label packaging that may exist through our existing distribution channels. Overall, this business segment will provide us the great potential for growth.

Food ingredients, as well as retail and food service, are highly specialized. They appear to be less susceptible to the cyclical patterns in the global commodity business. Our focus in this area comes not only for our desire to expand the business, but also to support the initiatives to diversify, utilize our origination and processing strengths, increase our capacity utilization, and ultimately smooth out our earnings throughout the year.

Our core legacy business is changing too, as our business concentration moves away from our reliance on lentils and adds more beans, chickpeas, popcorn, rice, durum wheat milling and other pulses and grains to ensure that we balance our geographies for distribution, our products available for sales, our macroeconomic profiles and our return profiles.

With the addition of the new lines in our legacy business, we're optimistic about our ability to create new sales and revenue opportunities while leveraging our strengths. We expect this will assist us in maintaining a healthy and more predictable earnings profile, generating free cash flow to fund our growth, reduce our debt and provide value to our shareholders.

I thank you for your interest in Alliance Grain Traders, and I'm going turn it back over to Omer to moderate some questions.

OMER AL-KATIB:
Thanks, Murad. Operator, I think we'll take the first question.

OPERATOR:
Your first question today comes from Jacob Bout of CIBC, please go ahead.

JACOB BOUT:

Good morning. The improvement you were seeing in the margin per tonne in the pulses and grain processing, maybe just put it in buckets of higher volumes versus higher prices versus mix of product. And maybe talk a little bit about how much lentils were in the quarter.

MURAD AL-KATIB:

Well, Jacob, certainly when you look at the overall tonnages for this quarter being down, I certainly don't think that the improvement that we saw is a volume-driven metric. Certainly, if we look at our pulses segment, we're back up into that high 50s range on EBITDA per metric tonne, and the pulses segment that we disclosed this quarter. We're getting back to levels where we were in the 2010 period, and prior to the 2011 financial crisis.

I would suggest that the bulk of that improvement comes from product mix. And when we look at the margin compression that we saw back in the late ‘11 and ‘12 period, we were struggling for utilization *period*, taking opportunities in peas, in canary seed, in flax seed, for the industrial solvent markets in China. We were utilizing plant capacity to generate cash flow. Today, we're back into this mix that it took time to build.

I mean, you can't become the world's largest chickpea shipper to balance your lentil platform overnight. It took us 2 years of effort on distribution, some of the Cap Ex that we spent was on facility revisions to ensure we could handle chickpeas, in multiple geographies. You're seeing the benefits of that strategy piece, that even in the tough earnings cycle, Jacob, we were investing in a way to ensure that we brought lentils down to—our target would be that it should make up less than one-third of our total geographic revenue.

And not that there's anything wrong with our lentil profile—but the bottom line is when you're 25 to 28% of the world trade of a particular commodity, when that commodity does go into a cycle, you end up in a position where you're susceptible to earnings of volatility. I mean, the entire game here for us is stability of our earnings. And you know, that's why, again, I think that the chickpea, bean, rice, and durum wheat milling are really good balances for the traditional legacy business of lentils. And when you add in the first tonnes of the food ingredient, that probably had a small effect on the gross margins, and the earnings, that we saw in that segment. But you know, certainly, Jacob, I wouldn't characterize price gains as contributed. Really, we saw the opposite. In the third quarter, we had significant price deceleration. And so for some of our analysts, part of the thesis is that in order for our earnings to be strong, or our margins to be strong, we need commodity price acceleration. Once again, in quarter three, we show that in a significant deceleration environment we had improved margins.

So, again, long answer, Jacob, but really it's product mix. It continues to—well, product mix and geographies, I think those would be the two things that really contributed. I mean, the geographic strategy is aimed at—if we were entirely a North American and an Australian company, this quarter, we wouldn't have had such strong earnings. Because we were a very late harvest, we had significant price deceleration in North America on the pulses side in terms of prices, which left the available stocks that were in hand in tight hands, because farmers were anticipating that if there was a late harvest there was the potential for quality problems. So product wasn't coming freely. What balanced us? Turkey had a strong performance, Southern Africa had a strong performance, China, India and Europe all performed well, that gave us a strong earnings balance. That's part of the goal long-term.

JACOB BOUT:

Just as a follow-up, just on the mix, if you're comparing year on year, what was the change in mix, say, year on year, lentils, peas, beans, and rice, roughly?

MURAD AL-KATIB:

You can see that in our segmented revenue, you can see that the other segment is actually very strong here. And so the other, meaning the rice and other commodities, we've been putting a lot of effort on the rice side, with our mill, and also on import and distribution of rice. The United Nations business related to a distribution of staples in different refugee relief programs have contributed, as well. I'd say lentils were down to that 35% range. If we look at it a year ago, we were probably at 55%. So certainly an ability to diversify.

JACOB BOUT:

And the doubling of the supply and tonnage but yet earnings being had, what was the driver there?

MURAD AL-KATIB:

Yeah, Lori mentioned the rail side of Australia. You know, Australia is a very interesting country in that we end up in a position where transportation from inland locations is very different than it is in Canada. In Canada, we have the new national railways, we have kind of feast and famine service depending on what's going on in the dynamics of the economy. In Australia, we have to create the transportation, in our New South Wales operation in particular, we have a take or pay rail contract. So when we're at the end of commodity cycles and there are no pulses left in the system and we're waiting for a new crop harvest, we have to resort to cereal, sorghum, other products going into that chain so that we don't pay empty rail freight. So certainly, that would have been one of the contributors—boosting volumes to basically avoid penalties on the rail contract. The good news is we only see that phenomenon in quarter three; by quarter four we're back shipping rail capacity that is related to the new harvest.

OPERATOR:

The next question comes from Steve Hansen of Raymond James. Please go ahead.

STEVE HANSEN:

Yeah, good morning. Can you help me understand the tonnage metrics, and I understand that Minot could scale just about 100,000 tonnes through new lines. Could you talk about the conversion in Canada and Turkey and just how the tonnage would sort of fall out?

MURAD AL-KATIB:

Obviously the pace of conversion—this would be the first time we gave you a little bit of visibility into our view of the pace. And our goal at this point, and it will obviously be driven by sales opportunity, our goal is to ramp up utilization of facilities that we've built, and lines that we've built, and the minute we have a view as management, that we have a sustainable, clear view towards full utilization, we're going to be adding incremental capacity. So this is—I can tell you that the first plant, and the first line, was certainly, there was some visibility with the Cargill agreement that we signed. But it was a build it and they will come type mentality. We had no choice. We had to build the first facility. So Cargill helped us to diversify that risk. We knew there was going to be some demand coming from that line from the first day of production, assuming, of course, that we could not only build it, operate it, but deliver the specification, which we've done successfully.

From there, it's all about building. So 35,000 tonnes of the capacity of line one in Minot; we could add two additional production lines, and the Cap Ex cost of that is likely in the range of $7 million total. One you build the large scale infrastructure, storage, buildings, receiving pits, warehouses, you literally have to plop in two lines, connect them, and commission them, and you're ready to go in 90 days. So our first goal will be to get Minot to a full 100 to 115,000 tonnes of full utilization. Then we'll look at conversion opportunities incrementally.

There are really three plants that would be the main conversion targets. It would be Regina, splitting plant; Turkish splitting operations, or portions thereof; and Williston, North Dakota. We have a second North Dakota opportunity that we could look at for conversion. And the conversion, if we look at our splitting plants, with the exception of Turkey, which would be around 300,000 tonnes of capacity, we have literally about 100 to 120,000 tonnes at each location. So they're well-suited to either do a full conversion, or a partial conversion.

Now, in my mind, it's all going to come down to the metrics of what we're delivering margin-wise. If we're in a position where we literally are delivering a margin profile that is significantly superior to the legacy business, it will warrant—and demand is there sustainably—it will warrant us to look at conversion. And so the plan will be to look at the pace of conversion, relate it to the commercial market development of the sales program.

Now, Canada would likely be a conversion target early on, because we do expect that the growth in sales opportunities is going to be from both the United States and Europe. Now, we do have a significant opportunity ahead of us, in that the recently-announced Harper Government Canada-Europe trade agreement contains provisions within it that actually reduce taxes and duties on pulses, flours, and fractions to 0 in certain products and down from 12-13% to 7% and phasing out over time. So market access out of Canada into Europe is going to be a very enhanced opportunity going forward. So, if you basically take the 100,000 tonnes at Minot, we'd have a goal by '14, '15, into '16. I'd like to see us double the capacity through a conversion, and then triple it.

OPERATOR:

The next question comes from Christine Healy of Scotiabank. Please go ahead.

CHRISTINE HEALY:

Thanks, hi, guys. We saw a nice decline in A.R. this quarter. Was that largely due to a change in your terms where you're collecting sooner from your customers, and was any of it related to the taking more off the balance sheet through factoring? If you could talk to the sustainability of that A.R. improvement, that'd be helpful.

MURAD AL-KATIB:

I can give a perspective, but Lori, do you want to go first? Go ahead, Lori.

LORI IRELAND:

With the combination of both, we do have a couple of different A.R. programs that we're working on. We're trying to tighten up our terms with our customers, and the factoring would have contributed somewhat, but not a huge amount. I think the biggest thing was in quarter two, near the end of quarter two, we had a quite a bit of invoicing done from Canada and Australia. And in both those areas, the quarter three really focused on collecting from those invoices.

CHRISTINE HEALY:

Okay.

MURAD AL-KATIB:

I think certainly, Christine, terms are tightening, and we can see—when I look at the overall gains, the inventory turn gain from—I think it was 86 days at the worst to 77. We've got work to do there to continue to move that along. But the A.R. side I'm quite pleased. To get down to a cash cycle on our A.R. collection of 56 when you're considering a lot of cases cash against document sales, with a transit time of up to 40 to 50 days, so when we're doing a lot of West Coast Vancouver shipping into the Med region, because even though it's very counterintuitive, Montreal to Europe, Middle East, is about, say, 28, 30 days transit, and from Vancouver, it's about 47 days transit. But I would say over the last 9 months, 75% of our volume destined for the Mediterranean is going via Vancouver because the freight rates are actually quite bit more competitive. So with a 47-day transit time and a 56-day cash cycle, we've tightened terms. And this was all part of what we went back to our distribution to say: when times were tough, we supported our distribution as a necessity of continuing the healthy development of our distribution network for future periods earnings.

When things started to improve, everybody has to pay their own way. And we're not a bank, and we make that very, very clear to our clients, and that is not a thing that will change. Now, on the factoring, and the other things that Lori mentioned, I'd consider those sustainable gains, too. Because those programs aren't one-times. They're actually factoring lines that replenish themselves as those receivables are collected and dropped off. So they're non-recourse factoring lines, but once we drop off a large receivable that we've factored, then we can actually re-factor another one. So these gains will certainly continue.

OPERATOR:

The next question comes from Marc Robinson from Cormark Securities. Please go ahead.

MARC ROBINSON:

Good morning. In the segmented results, there's a pretty big decline in the Asian business offset by a very big increase in Middle East-North Africa. We don't have the export figures yet, but for September, but I mean, can you comment a little bit on whether you're seeing weakness into India already, and then a little bit of colour on what's happening in your traditional MENA markets as it relates to a recovery there.

MURAD AL-KATIB:

Good question, Marc. The first comment I would make is part, again, of the development strategy over ‘09, ‘10, ‘11, ‘12, even in this whole difficult period of earnings, was to ensure that we had augmented, and refined, our distribution around the world. And interestingly, when I look at the financial crisis of ‘08 and ’11, there's one benefit that it did bring to this company. What it did do was it actually refined our distribution system where the stronger importers that we stood behind and supported, and who honoured their obligations, have become stronger in their markets and have become a lot more connected to AGT in a lot of cases. So from that perspective, we have the ability to move around the world in a normalized supply demand fundamental where we're getting back to that normalized supply demand, and we're able to generate our margin exclusive of one region being the large driver.

So India, in the quarter three period, actually went through a very negative type of profile where the Indian Rupee decline was rapid, from a 56 down to a 69, and then it came back to around 62, 63, where it stays today. So as a result of that, we're very much in tune with the risk profile of our markets, in particular we have AGT India where we have, I think, 11 full-time staff on the ground now. You know, we're very in tune in the liquidity and the currency effects on large scale distribution. We scaled our program back. We anticipated the problems, the defaults, the currency devaluation effects on liquidity of some of the import chains and we diverted our efforts to Middle East-North Africa. And so that's why you saw a bit of a decline. The good news, with the recovery back to 62, we're now into the traditional shipping period, and pulses are consumed in general when temperatures do get cooler. This is a larger consumption period, in particular in a lot of markets, say, the Middle East, and North Africa, when it gets cold at night, people drink lentil soup. They eat more pulses in their diets, beans and chickpeas. So the traditional shipping period to India is in a stable kind of a situation today. So we've seen the resumption of demand in India. Middle East-North Africa region: very dynamic. You read a lot in the news recently about it, and what I would characterize it as is post-conflict benefit for AGT. Now, during the conflict period of 2011, Arab Spring, 2012, the hangover effects of both the political and the economic instability that came with Arab Spring in the political unrest, came a devaluation in currencies, and a problem on our earnings in our core region. And we can't forget that this company, AGT, and especially with the Arbel acquisition we did in 2009, that is our backyard. So the mixed North Africa is certainly one of the life-bloods of this company in terms of strength of our distribution.

We're seeing the benefit now where post-conflict stability programs, the United Nations refugee programs that Lori mentioned in her comments, these are adding significant and robust demand into our mix today. So that's why you see a big gain in our segmented other revenue category. Where the Turkish facilities in the port city of Mersin are perfect situated for import, reprocessing, repackaging—we're doing things, Mark, we're doing family parcel sales, we're taking up to 8 to 12 commodities and packaging them into master packages for United Nations, International Red Cross and other NGO distribution. Now, as analysts and investors, I want to be clear on one thing. I'm very happy to be contributing to the efforts of the United Nations and international aid agencies. But for us, it's a very significant business. And as one of the largest suppliers into that system, our infrastructure is well-suited to it, and we're very competitive with very large scale. We expect that to continue.

OPERATOR:

The next question comes from Anoop Prihar of GMP Securities. Please go ahead.

ANOOP PRIHAR:

Good morning. Just two questions on Minot. At the end of Q3, line one was at two-thirds utilization. Where are we on the metric today? Second of all, with respect to line two, it's the same size as line one, how much of line two's production would you have to have committed before you would feel comfortable advancing with the capital required to build that one?

MURAD AL-KATIB:

Good question, Anoop. From the end of the quarter, I would say in the last few weeks of the quarter, we were definitely ramping production up, and as I said, we got to about that two-thirds utilization. We've continued to advance our program in October and into November. And so you know, part of that is not only having client trialling of the commercial production, so we need to have the large-scale clients take their first orders, put it into their commercial production, and give us the green light to look at longer or larger supply agreements. The progress has been quite positive, so we have no issues on any of those types of things. The ramping up has advanced past the two-thirds utilization, we are further training new staff, I expect that by the end of November, we'll move the plant up to 24-hour-a-day production from its current 18 to 20 hours. And so before year end I would expect that we should be at full utilization of that particular line.

In terms of what we need for line two, when line one is running and sold, these sales are not like the legacy business. You know, success breeds success, and it's stickier revenue, and it's stickier earnings where users of these products are not commodity users. There's a reason they're using the product. And as they integrate it into their product mix, and ingredient mix, we see it expanding. For instance, I'll give you an example, a meat company in the United States took product for a bread crumb replacement application, they took our high viscosity flour, and they told us very honestly they were going to introduce it into one particular product to replace the breadcrumbs to make it gluten-free. And once they took the product and tested it, and liked it, and went to commercial production, they advised us that their R&D group was testing for eight additional products, and different applications, can move from breadcrumb to soy replacement, that’s another application that this meat company is looking at. You end up in a position where the sales visibility becomes apparent from the sales program.

So I think we were quite clear in our desire to get there, and allocate the capital, as quickly as we can. But I want to be very clear to the market. We're not building these things to talk about the fact that they're not utilized. And so we are going to take a very managed approach on our capital allocation. Good news is that every line of capital now is three, three-and-a-half million, so the big bulk of the Cap Ex has already been made. So I'd expect to give you further updates throughout quarter four, into quarter one, for the expansions.

ANOOP PRIHAR:

What has to happen before you decide to proceed with line two?

MURAD AL-KATIB:

I can tell you I'm not in Regina at our head office today, because I've spent the last couple of days traveling in the United States, and in Canada, meeting with large-scale clients. And we're starting to get to a point where we're discussing 2014 requirements with those clients. And so when we start to have application acceptance of our ingredients, that drives us to a point where that visibility is becoming much more clear. So what has to happen, Anoop, is a little bit of time where we've now been, I would say, if I said it in the MD&A that we were nearing completion on commissioning, I would tell you we're commissioned on line one now. What the final stage of commissioning is for us was just the final tweaks. The things I look at, Anoop, is it producing to the quantity I thought it would? Is it producing to the quality I thought it would? And is it producing at the efficiency that I thought it would? Because those three metrics drive into your economic model on the return profile, on our return on both invested capital and the working capital required to run it. I'm getting a very strong comfort level in all of those metrics. And the sales side is becoming much more clear. The opportunity in protein and fibre—we today, I feel like we would have an ability to sell all we could produce in Minot. Even in three lines. But the starch, the high viscosity flour is the sales opportunity we have to develop, and that's progressing well.

OPERATOR:

As a reminder, if you'd like to ask a question, please press star and one on your touchtone phone. Our next question comes from Stephen Ottridge of BMO Capital Markets. Please go ahead.

STEPHEN OTTRIDGE:

Good morning, everyone. Wheat flour consumption has fallen to a 22-year low, according to the U.S. Department of Agriculture, partly due to the work of gluten-free products out there. Do you anticipate a large increase in this? Are you foreseeing that into the future?

MURAD AL-KATIB:

Very good question, and thank you for asking. For those of you who have been following this story you know we have been talking about gluten-free and non-GMO as a main attribute of pulses. And I can tell you one thing: gluten-free and non-GMO, was not high on the minds of Indian, Pakistani, Sri Lankans, Arabs, Turks, who were eating these products every day. They were eating them because of the traditional nature of the commodities and the fact that they are staples within their diets.

AGT has been talking about gluten-free and non-GMO because of the trends we've been seeing develop through the North American, Western European and other more developed geographies in the world in terms of both retail and consumer food markets. So, this gluten-free trend in the United States, I think there's going to be a couple of things, both in the U.S. and in Europe, I think we're going to see a continued move towards the development of good-tasting, or properly-tasting gluten-free products. Today one of the challenges is if you have a gluten allergy, so you're celiac, or you have a gluten intolerance—having an ailment, digestive or otherwise from the consumption of gluten, the product choice, the product quality, and in particular the palatability, the taste profile and the texture of these products is off, it's not as developed. It's getting better dramatically quickly, and that's an R&D product development type of thing.

We see the profile as one that is going to continue. And we don't think that this is a fad diet type thing. I think I saw an article, I think it was in maybe Bloomberg, don't quote me on the source, it actually attributed the reduction in gluten trend as a fad diet kind of—or a special diet, kind of a characterization. We think this is a sustainable trend. We think that consumers who are not celiac or gluten intolerant still will continue to have a perception that they would like to reduce their gluten. And so we're seeing food companies reacting with a desire for gluten-free ingredients that provide them with a different nutritional profile as well. What we love about our pursuit in the food ingredients is that we're marketing it as protein, and as fibre, and really what we're marketing is that ingredient that is protein and fibre but then has the gluten-free benefit.

What we look at seeing happening—I have to switch to Europe for a second—European areas, particularly in the United Kingdom, have the highest rates of celiac of any region in the world. We see this trend continuing. I have to mention the non-GMO as well. In Europe, of course, that's a very big opportunity. But we are seeing a significant traction in the United States on non-GMO, and some of you may have read groups coming out criticising different breakfast cereal brands because of their use of genetically modified corn. And so we see this trend there as a natural, clean deck-type product. So clean deck, meaning not modified ingredients, not solvent extracted ingredients. Clean deck, natural ingredients, not necessarily organic, it can be conventional, but natural, as a significant growth industry, and we expect that to grow by the tens of millions of dollars in the coming three to five-year period. That's the wheelhouse that we're fitting into. And that's the strength and the pace that we're going to see on the ramp-up of this food ingredient initiative. Because no one has ever produced pulse ingredients at a high volume with a consistent specification on an economically competitive basis. And from that perspective, I think that's going to be the driver of the initiative.

OPERATOR:

The next question comes from John Chu of Altacorp Capital. Please go ahead.

JOHN CHU:

Good morning. A couple questions on the post ingredient Minot. For lines two and three, can you build just line two separately, does it make sense to do two and three together just in terms of cost savings, and how do you look at that going forward?

MURAD AL-KATIB:

We've built out, so literally when you come and tour the plant, you're going to see a block space for line two, and a block space for line three, you even will look up at the wall and see the spouts that are connecting to the air system are already spouted and ready. So we literally can put in line two independently and line three independently, with only a 90 to 120-day cycle to commissioning. I would expect them to stage. So, again, there's no reason, even though it's only three to three-and-a-half million of capital. We are going to spend the capital, utilize the line, once the second line gets to that two-thirds utilization and I can see it's moving towards full utilization, then it's time to pull the trigger on the next line. So we'll keep staging. I see that being the staging, where if this works out, as I think it may we have the opportunity to potentially ramp utilization every one or two quarters, where you start to end up developing more and more opportunities. So you start to scale lines every three to 6 months. If we do that over the course of 3 years, even 2 years, you'll build some significant scale, and make it, as I put in my comments, a material contributor to earnings.

JOHN CHU:

And how much would it cost to convert the Canadian—Regina, or the Williston facility, and similar with the Turkish.

MURAD AL-KATIB:

$12 to $15 million versus a greenfield build that'd cost us in excess of 30 million when we ramp up the other lines. The other two would be somewhere around 35 million. Probably 12 to 15 million. So you're adding another 100,000 tonnes of capacity for a significantly lower capital cost. I have to make a comment on why did I build a Greenfield when had I extra capacity that I could have converted? I just want to make it clear, we made the decision early, and it was the right decision. The first plant with a focus on U.S. food companies is a U.S. origin product factory, we have no border issues, we have no supply chain issues, to do just-in-time delivery, and we wanted no reason for a food company to be cautious or worried about the supply chain coming from a Canadian plant into a U.S. food manufacturing sector. So that's why Minot made sense to be the first. But the conversions beyond that, I would expect, Canada and Turkey will be either number two or number three, moving between the two of them.

OPERATOR:

As an additional reminder, press star and one if you have a question. The next question is a follow-up from Steve Hansen of Raymond James. Please go ahead.

STEVE HANSEN:

Yeah Murad, just a follow-up on the type of agreements you expect to find on a go-forward basis; the Cargill agreement is a great sort of bedrock foundation for the platform. Should we expect other five-year type agreements from some of these other food and feed or agriculture-related the companies, or are they going to be one-off stage contracts with no visibility for us as analysts?

MURAD AL-KATIB:

Steve, I don't know the answer to that. It really depends on how we choose the food distribution side of this business. Because one strategy will be to have one or two commercialization partners as we did in the pet food branded ingredient and aquaculture sectors on the protein side with Cargill. We're examining the complementarity of some of the ingredient companies in the world that have expressed interest in more distribution and joint collaborative development-type agreements. And so we'll be looking at that and making decisions in the coming one or two quarters. With relation to the clients, I can tell you that we have joint development, nondisclosure R&D agreements with a number of major food companies already in place. And those will lead to supply agreements. Those supply agreements will not be clearly visible to analysts. We're under confidentiality rules with those agreements. You can appreciate that a large scale breakfast cereal company or pasta manufacturer would not want the world to know that they have a long-term supply contract with one particular ingredient supplier.

You're going to see it ramping, though. So you're not going see necessarily this announcement, but you're going to see a segment where you're going to see tonnages disclosed, margins, earnings profiles. I can tell you that my feeling, that revenue is—I keep using the word sticky, and really not susceptible to those macroeconomic conditions. That's what we like about this segment. They don't change because we become a foundation ingredient in a blend or a product that's branded.

OPERATOR:

We have an official follow-up from John Chu of Altacorp Capital. Please go ahead.

JOHN CHU:

Hi, Murad, a few quick questions here, has Cargill been doing any testing on the food side, or has it just been on the pet food?

MURAD AL-KATIB:

John, you'll have to repeat you question.

JOHN CHU:

Has Cargill been tacking any product to test on food, or has it just been on the pet side?

MURAD AL-KATIB:

You know what, John, like in terms of specific companies testing, and utilization, I can't really make any comments. But what I can tell you is that we have a very large list of food companies that are buying product already and in testing phases. So we're quite happy with the progress that we have there.

JOHN CHU:

Okay. And then just lastly, the product mix that you have, you're saying lentils are 35%. How low do you think that can get going forward? Could we get less than 30, or 25?

MURAD AL-KATIB:

I would expect that my COO, myself, and our executive chairman, and Lori, when we sat down we had targeted it to be around somewhere between a quarter and a third. And once again, I want to—I keep reiterating, I feel like the guy who started a lentil platform and took it into a global platform defends it. Lentils are a good business. They're the foundation of our legacy business. The issue of reducing the concentration was as we grow, it just makes sense for us not to have to push revenue or utilization through that platform, eroding our own margins, we actually get a chance now to sit back and say I'm not going to do lentils at that plant because I have more than my share of green pea sales into the canning and snack food markets. So this factory can utilize that in green peas. Or you know what, I've got B90 chickpeas that can run at this factory instead of lentils. And we saw that over the course of quarter three with the Indian currency devaluation, we had plants that we were wholesale changing over to things like chickpeas; canary seed has been quite a strong commodity for us over the past 6 months. You know, we've seen good opportunities on bagged and packaged canary seed. We don't talk about it a lot. But we have a bird food ingredient business that we own through the Poortmans London operation in the United Kingdom, where we're a major supply of bird food ingredients. The reduction in lentils down to 33%, down maybe to 30, maybe coming as low as 25, I think that's a good balance. If one commodity with multiple sub commodities is a quarter, or a third of your revenue, that's a good position. But I want to be diversified.

OMER AL-KATIB:

Thanks a lot, Murad. And that brings us to the end of our questions, and I would like to thank you all for joining us. I would like to remind that if you have any follow-up questions, you can feel free to contact us at our Regina office, and we'll be more than happy to follow up with you. Again, thanks for attending our conference call and I wish you all a very good day.

OPERATOR:

Ladies and Gentlemen, this concludes today's conference call. You may now disconnect your lines. Thank you for participating, and have a pleasant day.